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In the Supreme Court of the United States

OCTOBER TERM, 1947

No. 221

MORRIS EISENBERG, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

No. 222

HERMAN SCHAEFFER, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE

ON PETITION FOR WRITS OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE THIRD CIRCUIT

BRIEF FOR THE RESPONDENT IN OPPOSITION

OPINIONS BELOW

The findings of fact and opinion of the Tax Court (R. 7a–29a) are reported in 5 T. C. 856. The opinion of the Circuit Court of Appeals for the Third Circuit (R. 34) is reported in 161 F. (2d) 506.

JURISDICTION

The judgments of the Circuit Court of Appeals were entered April 22, 1947. (R. 43, 44.) The petition for writs of certiorari was filed July 22, 1947. The jurisdiction of this Court is invoked under Section 240 (a) of the Judicial Code, as amended by the Act of February 13, 1925.

QUESTION PRESENTED

Whether, in the years 1940 and 1941, each of the petitioners was taxable under Section 22 (a) of the Internal Revenue Code with respect to the income of certain identical trusts created by him on January 3, 1940, for the benefit of each of his children, to which he purportedly transferred percentages of his interest in a certain partnership.

STATUTE AND REGULATIONS INVOLVED

Internal Revenue Code:

> SEC. 22. GROSS INCOME.
>
> (a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealing in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried

on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1940 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1940 ed., Sec. 181.)

Treasury Regulations 103, promulgated under the Internal Revenue Code:

SEC. 19.22 (a)-1. *What included in gross income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22 (b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

* * * * *

STATEMENT

The facts as found by both the Tax Court and the court below may be summarized as follows:

In 1937, the petitioners entered into an oral agreement of partnership for the conduct of a retail furniture establishment under the name of "Bailey's Furniture Company." (R. 34.)

On December 30, 1939, they executed written articles of partnership, continuing the partnership from year to year, each partner to receive an annual salary. It was expressly provided that payment of the respective shares of profit was to be made only if and when the parties so determined. (R. 35.)

Three days later, on January 2, 1940, each of the petitioners created a separate trust for each of his minor children, the petitioner Eisenberg creating three and the petitioner Schaeffer four, to which each in the aggregate transferred fifty percent of his interest in the partnership. (R. 35–36.)

Each trust provided that its beneficiary could elect to become a partner upon reaching the age of forty, or upon reaching the age of thirty if the trustee died, and that if he was not admitted as a partner, or chose not to become a partner, he could either withdraw his share of the principal and income under conditions specified therein or elect to retain an inactive interest in the business. All income was to be accumulated until then, except that the trustee was empowered in his sole discretion to expend for or pay to the beneficiary any part of the trust fund prior to his attaining the age of thirty, or forty, years, as the case might be. (R. 36–37.)

Each trust also provided that the trustee could pledge any of the trust funds as collateral security

for loans and for use in the management and operation of Bailey's Furniture Company. (R. 37.)

On the day after the execution of the trusts, January 3, 1940, the petitioners, individually and as trustees, executed an addendum to the articles of co-partnership, purporting to make the various trusts members of the partnership and subjecting them to the partnership agreement. (R. 37–38.)

No services were rendered to the partnership by any of the children of either of the petitioners, except by Raymond Schaeffer during the period from January to December, 1941, for which he was paid. (R. 38.)

No distribution of either corpus or income of the trusts was made in 1940 or 1941, but the petitioners, as trustees, filed income tax returns for 1940 and 1941 in behalf of the trusts, reporting income of the Bailey Furniture Company which was credited to the respective capital accounts of the trusts on the books of the company. (R. 38.)

On these facts,[1] the Tax Court determined that, under Section 22 (a) of the Internal Revenue Code, as authoritatively construed in *Helvering*

[1] In 1943, the trusts were reformed under order of the Court of Common Pleas. The Tax Court, however, based its decision on the trusts as originally written on January 2, 1940. (R. 27a.) Its action in this respect was approved by the Circuit Court of Appeals. (R. 42–43.) No error is assigned by the petitioners on this account. Since no reference to the reformation of the instruments is made in the petition for certiorari, we have also attached no significance to it.

v. *Clifford,* 309 U. S. 331, the petitioners were taxable on all the income of the partnership business. The Tax Court made no finding as to the nature of the partnership. The court below assumed that it did not do so, perhaps because the decisions in *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293, had at that time not been announced. (R. 40.)

The Circuit Court of Appeals regarded the general principles applied by the Tax Court as beyond dispute, namely that the grantor of a trust remains taxable on the trust income under Section 22 (a) when the benefits directly or indirectly retained by him blend imperceptibly with the normal concept of ownership, and that, moreover, the Tax Court's determination in this type of case, if supported by evidence, was conclusive upon the appellate court, regardless of whether it was inclined to draw the same conclusion or make the same inference. (R. 41.) In this connection, the court agreed with the expressions in *Hash* v. *Commissioner,* 152 F. (2d) 722, 725 (C. C. A. 4th), certiorari denied, 328 U. S. 838, rehearing denied, 328 U. S. 879, that in this field, particularly, each case turned on its own facts, and that the appellate court's function ceased when it determined that the record as a whole furnished substantial basis for the inferences drawn by the Tax Court. (R. 41–42.) The court below went on to say that, in its opinion, the Tax Court could reasonably have concluded, as it did, that the arrangements made

by the petitioners did not effect a change in their economic status, but multiplied, in form, a single economic unit. (R. 42.)

Accordingly, the court below affirmed the order of the Tax Court in each proceeding. (R. 43.)

ARGUMENT

Both the Tax Court and the Circuit Court of Appeals concluded that the case was ruled on its facts by *Helvering* v. *Clifford,* 309 U. S. 331. Both courts pointed out that, in view of the bundle of rights reserved by him in the trust fund, each petitioner, as an individual partner and as trustee, could during the taxable years 1940 and 1941 prevent the distribution of any partnership income and compel the trust to leave the income in and subject to the commercial hazards of the business until the termination of the trust. (R. 25a, 26a; 41, 42.) We submit that further review by this Court is not warranted.

1. The decision of the Circuit Court of Appeals is not in conflict with *Montgomery* v. *Thomas,* 146 F. (2d) 76 (C. C. A. 5th); *Commissioner* v. *Olds,* 60 F. (2d) 252 (C. C. A. 6th); *Armstrong* v. *Commissioner,* 143 F. (2d) 700 (C. C. A. 10th); or *Thomas* v. *Feldman,* 158 F. (2d) 488 (C. C. A. 5th), as the petitioners assert. (Pet. 5.) Each of these cases turned upon its own peculiar facts, which are essentially different from those here presented, and it is unnecessary to inquire here into the correctness of each of such decisions. As the court

below said, little can be accomplished towards ultimate determination of the tax liability, at least in this class of cases, by ferreting out analogous parts of other cases, particularly since no one fact is decisive. (R. 41.)

2. The petitioners also assert (Pet. 8) that the court below erred in holding the trusts in question invalid for tax purposes, "despite the Tax Court's failure to find that there was no actual partnership or that the trusts did not effect a change of ownership." Apparently the petitioners contend that implicit in the lower court's alleged holding that the trusts were invalid is the further holding that there was no actual partnership created in which the trusts, and hence the minor children, were partners.

The court below, however, did not hold the trusts to be invalid or that no partnership was created between the petitioners and the trusts. While it stated that the Tax Court had evidently concluded that the gifts in trust were not complete, the court below rested its holding on the ground that, on the facts in the case, the Tax Court could reasonably have reached the conclusion it did. And, as regards the alleged agreement of partnership between the petitioners and the trusts, or its validity, the court below made no reference thereto other than that the addendum to the article of partnership executed January 3, 1940, in effect, purported to make the various trusts members of the partnership and subjected them to the partner-

ship agreement (R. 37–38), and that, in deciding the case upon the authority of the *Clifford* case, the Tax Court had made no finding as to the nature of the partnership (R. 40).

The Tax Court did not hold the trusts to be invalid, and it made no finding as to the alleged membership of the trusts in the partnership. It was obviously unnecessary for the Tax Court to have done so, since it based its decision on the *Clifford* case, holding decisive the fact that the petitioners had reserved a right in both the corpus and income of each of the trusts. (R. 24a–26a.) Moreover, although the Commissioner had alternatively argued in the Tax Court that there was no valid partnership created between the petitioners and the trusts (R. 23a–24a), the Tax Court apparently did not consider it necessary to pass upon the validity of any agreement which the partnership may have entered into with the trusts, or whether under the addendum to the partnership articles, referred to above, a partnership had been created between the petitioners and the trusts.

3. Finally, the petitioners assert (Pet. 8–9) that, in holding them liable to the tax upon the income of the trusts, the court below "proceeded upon the reasoning of cases involving the interests of wives," particularly the *Clifford* case and *Commissioner* v. *Tower,* 327 U. S. 280, and *Lusthaus* v. *Commissioner,* 327 U. S. 293. None of these cases, say petitioners (Pet. 9–11), "considers the

rights of children as distinguished from those of wives in similar situations." In this connection, the petitioners point out (Pet. 9–11) that, in the *Montgomery, Olds, Armstrong,* and *Feldman* cases, *supra,* with which the lower court's decision in this case, holding the *Clifford* doctrine applicable, is alleged to be in conflict, the Circuit Courts of Appeals have sustained the validity for tax purposes of gifts of interests in partnerships to minor children.

On the foregoing premise, the petitioners conclude (Pet. 11) that, in view of the multitude of family partnership cases, the question whether the doctrine of the *Tower* and *Lusthaus* decisions is to be extended to situations involving children is likely to be of considerable public importance, and that it would, therefore, seem desirable that any doubts as to the validity or invalidity of partnerships with children be resolved by decision of this Court.

But, as we have argued, no such question is involved in the decision below. While there can be little doubt that the principle of *Tower* and *Lusthaus* is applicable to family partnerships of which minor children or trusts created for their benefit are members (cf. *Losh* v. *Commissioner,* 145 F. (2d) 456 (C. C. A. 10th); *Thorrez* v. *Commissioner,* 155 F. (2d) 791 (C. C. A. 6th); *Hash* v. *Commissioner, supra*), the question is not one which could properly be presented to this Court for review in this case. There is, therefore, no

occasion for this Court to review the decision of the court below in order to remand the case to the Tax Court for a finding as to "whether or not the trusts actually became partners," as the petitioners would have this Court do. (Pet. 12–13.)

CONCLUSION

For the reasons stated, the petition for writs of certiorari should be denied.

Respectfully submitted.

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